United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76 5044

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In re

INTERSTATE STORES, INC., et al.,

Debtors,

CALIFORNIA WHOLESALE ELECTRIC COMPANY, formerly known as Esgro, Inc.,

Appellant,

-against-

JOSEPH R. CROWLEY and HERBERT P. SIEGEL, as Reorganization Trustees for Interstate Stores, Inc., et al., Debtors,

Appellees.

On Appeal from the United States District Court
for the Southern District of New York

REPLY BRIEF OF APPELLANT CALIFORNIA WHOLESALE ELECTRIC COMPANY

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Preliminary Statement

California Wholesale Electric Company, formerly known as Esgro, Inc. (hereinafter referred to as "Esgro"), the Appellant, submits this brief in reply to the opposing brief of the Appellees, Joseph R. Crowley and Herbert B. Siegel, the Chapter X Reorganization Trustees appointed for Interstate Stores, Inc. and its affiliates, including White Front Stores, Inc. ("Trustees").

The facts and issues pertinent to the appeal have been fully set forth and discussed in Esgro's principal brief (Esgro's Brief at 6-14). However, the Trustees' brief contains certain material errors and misstatements constraining a reply. Further, subsequent to the filing of Esgro's principal brief several events have transpired which require discussion: (i) the Court has rendered an opinion in connection with Esgro's appeal from the District Court's order of September 1, 1976,* a copy of which is annexed hereto as Exhibit "A," which elucidates the rationale behind its issuance of the November 23, 1976 stay order; (ii) the Superior Court of the State of California (the "California Court") has rendered a judgment for the Trustees in connection with the action and cross-action pending therein (the "California Lawsuit") (SA 68)**; and (iii) Esgro has appealed the California Court's judgment to the California District Court of Appeal.

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* Sulmeyer v. Crowley et al., Docket No. 76-5034.

** References preceded by "SA" are to the supplemental appendix filed herein.

I.

THE ORDER OF THE DISTRICT COURT IS IN DIRECT CONTRAVENTION OF THIS COURT'S STAY ORDER

A. THIS COURT STAYED ALL PROCEEDINGS IN THE DISTRICT COURT RELATING TO THE ESGRO CLAIM.

Although the Trustees readily concede that District Judge Gagliardi's order striking Esgro's amended claim was not entered "until November 24, 1976, the day after this Court rendered its stay order" [Trustees' Brief at 10], the nonetheless argue that "there is nothing in this Court's November 23, 1976 order which prevented the District Court from making any appropriate order with respect to the amended proof of claim filed by Esgro." [Trustees' Brief at 10-11].

The opinion of this Court rendered on March 17, 1977 (the "Opinion") dispels any doubt regarding the Court's intention in issuing the November 23, 1977 stay order. The Court held that the California Bankruptcy Court's various restraining orders and injunctions mandated that the entire controversy between Esgro and the Trustees, including the nature of claims and cross-claims, be adjudicated by the California Court:

> "Meanwhile, in the United States District Court for the Central District of California in the Chapter XI proceeding of Esgro, a plan of arrangement, following several revisions in 1974, 1975 and March and April of 1976, was finally presented, agreed to,

and approved by the district court on May 18, 1976, and in the accompanying decree the United States District Court in California expressly reserved jurisdiction 'for the purpose of causing to be brought to trial those issues presented by the claim of ... [Esgro] against White Front Stores, and against Interstate Stores, Inc. and by White Front against ... [Esgro] and others ... ' to be determined in the plenary action in the Superior Court of California....

"The United States District Court in California had designated the California state court as the appropriate tribunal to try out, before a judge and jury, the plenary action to adjudicate the contested claims by White Front, Interstate Stores, Inc., et al., on the one hand and Esgro, et al., on the other.... In confirmation of Esgro's Chapter XI arrangement, the United States District Court for the Central District of California on May 18, 1976 again restrained and enjoined claimants against Esgro's estate for claims which had existed prior to Esgro's XI petition filed on March 31, 1973, from 'initiating any ... suits or proceedings ... ' against Esgro. This was plainly applicable to the White Front et al., claims against Esgro concerning which the United States District Court for Central California had expressly reserved jurisdiction and which was a vital part of the plenary suit in the California state court which the district court had authorized to proceed. It is, therefore, apparent that when on October 21, 1976, the Trustees for the estate of Interstate Stores (including White Front ... etc.), with the approval of the district court in New York, filed a counterclaim, consisting in substance of the same allegations as those in its complaint in White Front Stores v. Esgro in the state court of California and the same as those in White Front's proof of claim in Esgro's Chapter XI proceedings in the California bankruptcy court, the Trustees were acting in contravention of

> the restraining orders and injunctions issued by the United States District Court for the Central District of California in forbidding the initiation of suits against the debtor, Esgro."

Opinion at 4, 8-9 [Emphasis supplied].

The foregoing* conclusively demonstrates that the Court in issuing the November 23, 1976 stay order intended, indeed felt compelled, to leave to the California Court the entire dispute between the parties, including issues as to the nature of the claims and cross-claims. As recognized by the Trustees, it is "within the [trial court's] discretion to decide whether or not leave to amend [a pleading] should be granted...." [Trustees' Brief at 28].

More significantly, District Judge Gagliardi signed the order striking t amended claim on the premise that he would conduct the trial (A194)** and be the arbiter of admissible evidence under the original claim. In fact, in his memorandum

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* In the Opinion, the Court also mentioned the following factors as being "persuasive in designating the California [Court] as authorized by the United States District Court for the Central District of California as the appropriate tribunal for the determination of the respective claims of White Front Stores (Interstate Stores) et al., and Esgro, et al.":

> (1) Parties to the California Lawsuit were not subject to the jurisdiction of the New York Bankruptcy Court;
>
> (2) The events surrounding the controversy between the parties had transpired in the State of California; and
>
> (3) The convenience of the potential witnesses would best be served by a trial in California. [Opinion at 9-10].

** References preceded by "A" are to the joint appendix filed herein.

decision of December 15, 1976, District Judge Gagliardi stated "that the issues sought to be raised by the amended proof of claim might be able to be litigated on the basis of evidence admissable under the original proof of claim...." (A195).

The Trustees blithely ignore the fact that but for the September 1, 1976 order, the order stayed by this Court, the issue of amendments to pleadings would never have been before the District Court and would have remained with the California Court. The District Court's order striking the amended claim was a mere accident of the jurisdiction assumed by the District Court pending Esgro's appeal to this Court for reinstatement of the Bankruptcy Court's determination that the issues be tried in the California Court.

The Trustees further argue that the jurisdiction of this Court was limited to a review of that portion of the District Court's order which had "directed a trial of the Esgro matter before Judge Cannella." [Trustees' Brief at 11]. According to the Trustees, this Court, for some vague reason, lacked jurisdiction to stay the District Court from dismissing the Esgro amended claim. [Trustees' Brief at 11]. The Trustees' position is somehow based on their assertion that Esgro's appeal was limited to only that portion of the September 1, 1976 order expressly stated in the descriptive portion of its notice of appeal:

> "[Esgro] hereby appeals to the United States Court of Appeals for the Second Circuit from the order of the Honorable John M. Cannella, United States District Judge, dated September 1, 1976, setting aside the order of the Honorable Edward J. Ryan, Bankruptcy Judge, dated July 23, 1976 and setting a trial before this Court of the application of the [Trustees] to expunge the claim of [Esgro] commencing October 18, 1976." (JA 508)*

To quote a refrain coined by the Trustees, "[m]erely stating the argument, we respectfully suggest, demonstrates its absurdity." [Trustees' Brief at 31].**

The Trustees were aware from the commencement of the Sulmeyer v. Crowley et al., Docket No. 76-5034, appeal, that a review of the entire order of September 1, 1976 was being sought. In fact, in its application to the District Court for a stay of the September 1, 1976 order pending appeal, Esgro's counsel stated as follows:

> "I submit this affidavit in support of [Esgro's] motion under Fed. R. Civ. P. 62(c) for a stay pending [Esgro's] appeal from the decision and order of this court dated September 1, 1976

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* References preceded by "JA" refer to the joint appendix filed in the prior appeal in this matter entitled Sulmeyer v. Crowley, et al., Docket No. 76-5034.

** The Trustees also deem as a "very important fact" [Trustees' Brief at 10], not to be ignored, that "this Court's November 23 order was not physically entered [on the docket of] the Bankruptcy Court until November 26, 1976, two days after Judge Gagliardi's order was entered." [Trustees' Brief at 10]. Why this is "very important" the Trustees don't deign to elucidate. Perhaps, because they realize that the effectiveness of this Court's stay order was not contingent upon its being so docketed. See Fed. R. App. P. 36.

(the "Order"), which, inter alia, (i) sets aside the order of the Honorable Edward J. Ryan, dated July 23, 1976 modifying the stay of suits extant by virtue of Chapter X Rule 10-601; (ii) sets a trial before this court of the application of Joseph R. Crowley and Herbert B. Siegel, as Reorganization Trustees (the "Trustees"), to expunge the claim of [Esgro] (Claim No. 7273A), commencing October 18, 1976 at 10:00 A.M.; (iii) directs the parties to complete discovery prior to September 17, 1976; and (iv) directs the parties to stipulate to facts by October 12, 1976.

3. On September 2, 1976, [Esgro] filed with this court, a notice of appeal from the Order to the United States Court of Appeals for the Second Circuit."

"4. [Esgro] requests that the Order be suspended pending disposition of the appeal, for the following reasons:

(a) [Esgro] is unable to complete pre-trial discovery by September 27, 1976, the deadline fixed by the Order...."(JA 513-514).

The Trustees cite no authority for their assertion that this Court's jurisdiction is limited by the descriptive language in Appellant's notice of appeal, for there is none. In fact, the Trustees' position has been consistently rejected by the Supreme Court of the United States. United States v. Arizona, 206 F.2d 159 (9th Cir. 1953), rev'd, 346 U.S. 907 (1953); Forman v. Davis, 292 F.2d 85 (1st Cir. 1961), rev'd, 371 U.S. 178 (1962); State Farm Mut. Auto. Ins. Co. v. Palmer, 350 U.S. 944 (1956).

In United States v. Arizona, supra, the State of Arizona moved to dismiss a third-party complaint filed by the United States. The district court's order granted the motion to dismiss the complaint and went on to recite that "this case...is dismissed." 206 F.2d at 159-160. The notice of appeal filed by the United States stated that it appealed to the Court of Appeals for the Ninth Circuit from the order granting the motion to dismiss the complaint. The court of appeals, over the vehement dissent of Circuit Judge Pope, held that its review was restricted by the statement in the notice of appeal to the part of the order which dismissed the complaint. Finding that part of the order non-appealable because it was not final, and holding that the part which had dismissed the case itself was not before it because no appeal had been taken from that part, it dismissed the appeal. Circuit Judge Pope dissented and stated the following:

> "If the notice of appeal had merely referred to the order (entered on the 6th day of October 1952), and stopped there, or if it had followed this with the entire order, verbatim, I take it the majority here would have found it hard to void the appeal. But because in referring to the order, the appellant has mentioned part of it only, it would seem that it has been guilty of an irregularity, and although no one has been misled or failed to understand what was intended, the appeal must be dismissed!
>
> "Not only has the opinion here disregarded Rule 61 and § 2111 [28 U.S.C. § 2111], supra, but it has given them a

> twist little short of astounding. It is this: Counsel for the United States, because he was 'ignorant of the law', has made an 'error', (although it is not suggested anyone was misled by this 'error'). This 'error' gave the State of Arizona 'the substantial right of finality'. If the State of Arizona 'should be robbed of the advantage gained from its opponent's error by construing the two orders as if they were one', it would lose its substantial rights.
>
> "I can see how if one is misled or changes his position to his disadvantage because of his opponent's error, he may have some vested interest in that error, of which he should not be 'robbed'. But if a court, which has not been misled, is going to give an appellee which also is not misled, a 'substantial right' or a vested interest in an opponent's error, that is neither legerdemain, nor law, nor anything but an illustration of the 'sporting theory of justice' which Rule 61 and § 2111 were designed to end in the federal courts." 206 F.2d at 162.

The Supreme Court summarily reversed, sustaining Circuit Judge Pope's position.

In Forman v. Davis, supra, the district court entered a judgment dismissing plaintiff's complaint on December 19, 1960. On December 20, 1960, the plaintiff filed motions to vacate the judgment and to amend the complaint. While these motions were pending, the plaintiff, on January 17, 1961 appealed from the judgment entered on December 19, 1960. On January 23, 1961, the district court denied the motions filed on December 20, 1960. On January 26, 1961, the plaintiff appealed from the orders of January 23, 1961 denying the motions.

On its own motion, the court of appeals dismissed the appeal taken on January 17, 1961 as premature, because it was taken while a timely motion to vacate under Fed.R.Civ.P. 59(e) was pending. It then held that the appeal taken on January 26, 1961, was ineffective to effect review of the judgment of December 19, 1960, because the notice of appeal failed to designate that judgment as well as the orders denying the motions. Considering the appeal of January 26, 1961, as having been taken solely from the orders denying the motions to vacate and to amend, the court of appeals affirmed the district court on the ground that the record failed to show the matters placed before the district court in support of the motions and, consequently, could not support the necessary finding of abuse of discretion by the district court.

The Supreme Court reversed. In its view, even if the notice of appeal filed on January 26, 1961, restricted the court of appeals to review of the orders designated in the notice, the record demonstrated abuse of discretion by the district court. But the Court also held that the court of appeals had erred in holding that the notice of appeal was ineffective in the review of the original judgment by reason of its failure to designate it.

> "The defect in the second notice of appeal did not mislead or prejudice the respondent. With both notices of appeal before it (even granting the asserted ineffectiveness of the first), the Court of Appeals

> should have treated the appeal from the denial of the motions as an effective, although inept, attempt to appeal from the judgment sought to be vacated. Taking the two notices and the appeal papers together, petitioner's intention to seek review of both the dismissal and the denial of the motions was manifest. Not only did both parties brief and argue the merits of the earlier judgment on appeal, but petitioner's statement of points on which she intended to rely on appeal, submitted to both respondent and the court pursuant to rule, similarly demonstrated the intent to challenge the dismissal.
>
> "It is too late in the day and entirely contrary to the spirit of the Federal Rules of Civil Procedure for decisions on the merits to be avoided on the basis of such mere technicalities. 'The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits.' Conley v. Gibson, 355 US 41, 48, 2 L Ed 2d 80, 86, 78 S Ct 99. The Rules themselves provide that they are to be construed 'to secure the just, speedy and inexpensive determination of every action.' Rule 1." 371 U.S. at 181-182.

Thus, the Trustees' assertion that Esgro appealed from only a portion of the September 1, 1976 order and that this Court's jurisdiction was thereby limited, is wholly devoid of merit.

B. THE CALIFORNIA COURT INTERPRETED THE DISTRICT COURT'S ORDER AS A RESTRICTION ON ITS JURISDICTION.

The Trustees assert that Esgro's amended proof of claim "should [not] now be permitted to stand in light of the

California Court's decision not to permit an amendment to the cross-complaint." [Trustees' Brief at 12-13]. Whatever decision the California Court made is now properly the subject of an appeal in the California District Court of Appeal and is without the scope of this Court's jurisdiction. What is genuine to this appeal, however, is that the California Court's decision was influenced by the District Court's November 24, 1976 order striking the Esgro amended claim. Thus, the independent judgment of the California Court was impeded by the District Court's order, made on the erroneous assumption that the trial would be conducted in the District Court. That, the California Court interpreted the District Court's order of November 24, 1976, as limiting its jurisdiction, is amply demonstrated by that court's statements:

> "THE COURT: Let the record show that we have had a prolonged discussion about the question of filing an amended cross-complaint.... First of all, I think the pleading is defective in that it does not specify the precise elements of fraud which are required in a fraud action, the precise fraudulent acts and misrepresentations. That I am not too concerned with because I think that could be amended to take care of that particular situation. But the things that concern the court the most are the fact that there is pending in the District Court of New York a bankruptcy proceeding involving Interstate Stores and White Front Stores and that in those proceedings there is a claim filed which is substantially the same as the original cross-complaint filed in this action, and that there was a motion to file an amended cross-complaint [i.e.,

> the Esgro amended claim] in the bankruptcy court which would have been virtually identical to what is proposed to be the amended cross-complaint to be filed in this court, and the court in New York struck the amended claim and, consequently, that is not a matter of record before the bankruptcy court.
>
> "At or about the same time leave has been granted by the court in New York to proceed in a civil trial in California. It is my feeling that the civil trial in California must be tried within the parameters of the claim filed in New York because it appears to me that the leave to proceed in California is a circumscribed leave to proceed with the idea that the proceedings in California would not go beyond the proceedings in the bankruptcy court in New York. And for that reason I think it would be improper to go forward with an amended cross-complaint in California.
>
> "Now that particular issue may be resolved, as we know, by the motion to reconsider an order to show cause, as I understand it, in New York that is to be heard tomorrow at 5 p.m. And probably on Wednesday we will know what transpired there.
>
> "If the court in New York permits the filing of an amended claim in New York, that would enlarge the parameters of what the court in California could consider." (SA 46-47) [Emphasis supplied].

As a result of its decision striking Esgro's amended cross-complaint, the California Court refused to permit Esgro to introduce certain evidence at trial which would have established that: (1) the debtors misrepresented their financial condition to Esgro when they executed the license agreement in December, 1970; and (2) Esgro would never have entered

into the license agreement had it known of the debtors' true financial condition. The California Court also refused to instruct the jury that the debtors' misrepresentations of their financial condition at the time of the execution of the license agreement could be construed as showing that they knew they could not, and never intended to, fulfill their obligations to Esgro under their agreement.

The Trustees further attempt to minimize the effect of the District Court's order striking the Esgro amended claim by pointing to the fact that judgment in the California Lawsuit has been rendered against Esgro. As a result, the Trustees imply, the issues on appeal before this Court are academic. In fact, the District Court's order is of continuing importance since, as indicated previously, Esgro has filed an appeal from the judgment of the California Court to the California District Court of Appeal. Accordingly, should the California District Court of Appeal upset the judgment of the California Court and order a new trial, the effect of the District Court's order striking the Esgro amended claim on the jurisdiction of the California Court will, obviously, remain quite significant.

Esgro submits that only a vacatur of the District Court's order of November 24, 1976, will enable the California Court to independently adjudicate all the issues between the parties in the California Lawsuit as mandated by this Court's order of November 23, 1976, and the various orders and injunctions of the California Bankruptcy Court.

II.

THE DISTRICT COURT ABUSED ITS DISCRETION BY STRIKING THE ESGRO AMENDED CLAIM

A. ESGRO'S AMENDED PROOF OF CLAIM DOES NOT STATE AN ENTIRELY "NEW" CLAIM.

The Trustees assertion that Esgro's amended claim "seeks to introduce a distinctly new and different claim" [Trustees' Brief at 19], is inaccurate. As pointed out in Esgro's principal belief, Esgro's amended claim merely attempts to particularize the very same theories and events described in the initial claim on the basis of material gleaned during the course of pre-trial discovery. The amended claim alleges that in connection with, and after, the execution of the license agreement, Interstate Department Stores, Inc. and its affiliate, White Front Stores, Inc., made misrepresentations and material omissions concerning its financial condition and intentions to expand its chain of stores during the full term of the agreement. (A 23-24 at ¶3(c), (d) and (e)). It is alleged that the debtors' representations and assurances were untrue and that the specific nature of the misrepresented financial information is set forth in Paragraph 3(g) of the amended claim. (A 24-25). Despite the assertion of the Trustees to the contrary, it is still alleged, as in its initial proof of claim, that misrepresentations were made about

the debtors' intent to close stores. Paragraph 3(G)(iii) of the amended claim specifically alleges that the financial operations and conditions of the debtors in late 1970 was so bad and deteriorating so steadily and rapidly that a substantial number, if not all, of the White Front Stores would have to be disposed of or sold and that this was clear or should have been clear to management of the debtors when the license agreement was signed. (A 25). By any reasonable test, the amended proof of claim merely particularizes and better specifies the contentions and allegations raised and as to which the Trustees had notice.

As set forth in Esgro's principal brief, the applicable test for permitting an amendment to a proof of claim has been variously stated, but, in essence, the test is whether there is any reasonable relationship between the "new" claim and the "old" claim. In re G.L. Miller & Co., 45 F.2d 115 (2d Cir. 1930); Scottsville National Bank v. Gilmer, 37 F.2d 227 (4th Cir. 1930); In re Lipman, 65 F.2d 366 (2d Cir. 1933). Only those amendments which "seek to assert an entirely new, different, separate and distinct claim," [In re Diversified Brokers Co., 355 F. Supp. 76 (D. Mo. 1973) aff'd, 487 F.2d 355 (8th Cir. 1973)] are to be barred. The cases cited by the Trustees themselves and the applicable case law as set forth in Esgro's principal brief, make clear that this "amendment" was and is proper and appropriate.

The "test" proposed by the Trustees is that embodied by Fed.R.Civ.P. 15 [Trustees' Brief at 23-24]. The thrust of Fed.R.Civ.P. 15 has been stated as follows:

> "It re-emphasizes and assists in attaining the objectives of the rules on pleadings: that pleadings are not an end in themselves, but are only the means to a proper presentation of a case; that at all times they are to assist, not deter, the disposition of litigation on the merits." 3 Moore's, Federal Practice, ¶15.02[1] at 813 (1974).

The test under Fed.R.Civ.P. 15 proposed by the Trustees is, in essence, to determine whether evidence tending to support the facts alleged in the new amended pleading could have been introduced under the original pleading. See, e.g., Wisbey v. American Community Stores Corp., 288 F. Supp. 728, 732 (D. Neb. 1968).

This proposed test is easily met by the amended proof of claim here. Indeed, District Judge Gagliardi expressly stated that the issues raised by the amended claim might be litigated on the basis of facts admissible under the original proof of claim. (A195). Thus, on its face, the District Court's decision is erroneous. If the facts are admissible, the amendment should have been allowed.

The purported "new" allegations in the amended claim are that the debtors made certain misrepresentations concerning, or failed to disclose, their poor financial condition at the time. The evidence supportive of this "new" allegation would be testimony or evidence of the debtors' poor and deteriorating

financial condition in December 1970 and testimony that contrary representations were made to Esgro at the time or that the true facts were concealed and not disclosed to Esgro. Esgro's initial proof of claim alleged, among other things, that the debtors misrepresented, concealed and omitted to disclose that they intended to close or dispose of a number of the White Front stores. Certainly, evidence that the White Front operations had incurred 9-month losses of over $6,300,000 in late 1970 would be admissible evidence supporting, or tending to support, the original contention that White Front intended to close or dispose of these stores. Can it be seriously asserted that such evidence would not be found relevant at the time of trial even if that issue were so narrowly framed? To ask the question is to answer it. The representations and omissions made by the debtors in connection with, and subsequent to, the license agreement were clearly put in issue and raised in Esgro's initial proof of claim.

Most of the cases cited and discussed by the Trustees hold that the amendment there considered was proper. Of the cases holding otherwise, none of the factual principles involved have any similarity or application to this case.

In re G. L. Miller & Co., supra, involved an original claim for money had and received and an attempted amendment seeking to add "an entirely different cause of action" based upon an express indemnity agreement which was not even referred to in the original claim (45 F.2d at 116).

In re Starks, 55 F. Supp. 66 (E.D. Pa 1944), concluded that there was an insufficient relationship between an initial claim for money due on a loan and a proposed amendment seeking to add a claim for conversion of certain personal property.

In Tarbell v. Crex, 90 F.2d 683 (8th Cir. 1937), the "original claim" sought to be amended was a letter from counsel asking whether the bankruptcy was voluntary or involuntary.

It is unquestionable that both the initial proof of claim of Esgro and its amended proof of claim deal with the same transaction and the same basic operative facts, and state the same theories of liability. The amended proof of claim does not assert an "entirely new, different, separate and distinct claim." In re Diversified Brothers Co., supra. The evidence to be introduced to prove the amended proof of claim would have been admissible to prove Esgro's initial proof of claim. Therefore, the amended proof of claim is, and was, a proper amendment.

B. THE DISTRICT COURT'S FINDING THAT THE TRUSTEES WOULD BE PREJUDICED BY THE AMENDED CLAIM IS NOT SUPPORTED BY THE RECORD BELOW.

The Trustees have offered no evidence and have pointed to no facts to dispute Esgro's contentions that: (a) the issues and facts raised, to the extent they could possibly be found "new", have been interjected by the Trustees themselves;

and (b) any purported "prejudice" in the Trustees inability to take adequate discovery is attributable to their own neglect, and not to "new" pleadings.

The Trustees do not deny, nor can they, that in July 1976, it was clear that "Esgro felt that certain financial information had not been provided to it." (A 52 at ¶9). It is equally admitted by the Trustees that in mid-August 1976, California counsel for Esgro "brought up the subject of amending certain pleadings...including the amendment by Esgro of its cross-complaint." (A 53 at ¶10). In fact, California counsel for Esgro understood that an agreement had been reached for such an agreement. (A 93).

The Trustees base their assertion of prejudice on the ground that they did not have an adequate opportunity to take discovery with regard to Esgro's "new" claim. The Trustees, however, neglect to mention that they were responsible for the very abbreviated discovery schedule herein. In fact, the Trustees had consistently asserted from the commencement of the proceedings relating to the Esgro claim in the Bankruptcy Court on May 26, 1976, that they were ready for an immediate trial of the Esgro claim. By contrast, Esgro consistently maintained that it needed additional time to conduct and complete discovery since most of the facts and matters to be discovered involved operations and acts of White Front Stores, Inc., and its affiliated companies. In fact, the Trustees vehemently,

and successfully, opposed Esgro's application to both the District Court and this Court for a stay of the September 1, 1976 order* pending Esgro's appeal therefrom, primarily to permit the parties to continue to take discovery. In opposition to Esgro's motion for a stay to the District Court, the Trustees' counsel stated as follows:

> "The first argument advanced by [Esgro] in support of [its] application [for a stay] is that discovery cannot be completed by September 27, the deadline fixed by the Court. Reference is first made to [Esgro's] California Counsel's advice to [Esgro's] New York Counsel (whose affidavit is submitted in support of the application) to the effect that 'pretrial discovery is presently outstanding in the action and cross-action between the parties in the Superior Court of the State of California' and that '[b]ased upon information which [Esgro] expects to obtain in outstanding discovery, additional discovery will be required and will not be completed until the end of October, 1976.' I respectfully suggest that this argument need not concern the Court...." [Affidavit of Martin I. Shelton, September 13, 1976, at ¶4].

In view of the Trustees' position below, it is ironical that the Trustees now seek to bar Esgro from amending its claim because of their purported inability to take

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* The September 1, 1976 order severely curtailed Esgro's ability to conduct discovery concerning its $38 million dollar claim since it directed the parties to complete discovery by September 27, 1976. (JA 504).

adequate discovery in connection with the issues raised therein. The abbreviated discovery schedule suited the Trustees' purposes in the past, and they should not now be heard to grouse about its effects.

In filing its amended claim, Esgro was merely making use of facts gleaned during the course of pre-trial discovery. The Trustees' insistence on an extremely accelerated discovery schedule, resulted in Esgro's proceeding to trial on its approximately $38 million claim with only four months of trial preparation. Further, given the short time span before the proposed trial in the District Court, any amendment by the parties to any of its "pleadings" would have been virtually on the eve of trial. Clearly, Esgro should not be penalized by a denial of its right to amend its claim, something which this Court has repeatedly stated should be allowed with "great liberality,"* because of the litigation tact adopted by the Trustees.

Moreover, as pointed out in Esgro's principal brief, the purported "new issues of facts" in the amended claim were interjected by the Trustees themselves in their complaint of October 20, 1976. (A 10-20)**. The Trustees in their brief do

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* In re G. L. Miller & Co., 45 F.2d 115, 116 (2d Cir. 1930).

** The filing of which, this Court has recently held to have been "in contravention of the restraining orders and injunctions issued by the United States District Court for the Central District of California in forbidding the initiation of suits against the debtor, Esgro." [Opinion at 9].

not seriously deny this fact but assert "that all issues...have now been tried as part of the California [Lawsuit]." [Trustees' Brief at 33]. Thus, according to the Trustees, the issues presented herein are "of no significance." [Trustees' Brief at 33]. In fact, the issues presented in this appeal are of continuing significance since, as indicated above, Esgro has appealed the judgment of the California Court to the California District Court of Appeal. Therefore, should Esgro succeed in obtaining a new trial, and the District Court's order striking the amended claim continues to stand, the California Court will once again be faced with the question concerning the limits of its jurisdiction.

Accordingly, Esgro submits that the District Court's order of November 24, 1976, should be vacated.

CONCLUSION

The order of the District Court of November 24, 1976, as amended on December 15, 1976, striking and dismissing Esgro's amended proof of claim, should be vacated.

Respectfully,

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UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 402

September Term, 1976

(Argued October 14, 1976

Decided March 17, 1977

Docket No. 76-5034

In re INTERSTATE STORES, INC. formerly known as Interstate Department Stores, Inc. et al.,

Debtors-Appellees

IRVING SULMEYER, as Receiver for the Estate of ESGRO, INC., a Debtor in Chapter XI,

Plaintiff-Respondent-Appellant

v.

JOSEPH R. CROWLEY and HERBERT B. SIEGEL, as Reorganization Trustees for WHITE FRONT STORES, INC., et al.,

Defendants-Appellants-Appellees

Before MOORE, ANDERSON and GURFEIN, Circuit Judges.

Appeal by Sulmeyer, receiver for the Chapter XI Estate of Esgro, Inc., plaintiff-respondent below, from order by United States District Court for the Southern District of New York, John M. Cannella, Judge, revoking the reference to the Bankruptcy Judge of Chapter X proceeding of Interstate Stores, Inc., et al., and assigning the claim of Esgro for trial before the district court. Order for trial in United States District Court for the Southern District of New York stayed and parties ordered to proceed to trial of plenary action in Superior Court of State of California in accordance with prior direction of United States District Court for the Central District of California. Appeal dismissed as moot.

Harvey R. Miller, Esq., New York, N. Y. (Weil, Gotshal & Manges, Bruce R. Zirinsky, Esq., and Lawrence Mittman, Esq., New York, N. Y., on the brief) for Appellant Sulmeyer

Martin I. Shelton, Esq., New York, N. Y. (Shea Gould Climenko & Casey, and Daniel L. Carroll, Esq., New York, N. Y., on the brief) for Appellees

Irving H. Picard, Assistant General Counsel, Securities and Exchange Commission, Washington, D. C. (David Ferber, Solicitor, Securities and Exchange Commission, Washington, D. C.; Meryl E. Wiener, Esq., New York Regional Office, Securities and Exchange Commission, New York, N. Y., on the brief) for Appellee Securities and Exchange Commission

Joseph Leibowitz, Esq., for Senior Lenders

ANDERSON, Circuit Judge:

On February 15, 1973, White Front Stores, Inc., a California corporation and a wholly owned subsidiary of Interstate Stores, Inc., together with White Fronts' affiliates, instituted an action in the Superior Court of the State of California, County of Los Angeles, against Esgro, Inc. (Esgro), a California corporation having its principal place of business in that State. White Front Stores, Inc. (White Front) also had its principal place of business and operated and managed retail stores in California. The purpose of White Front's action against Esgro was to recover payments alleged to be due by Esgro under a license agreement whereby White Front granted certain concessions in its stores to Esgro for an agreed consideration.

On March 13, 1973, Esgro filed in the United States District Court for the Central District of California, a petition for an arrangement under Chapter XI of the Bankruptcy Act, §322. On March 19, 1973 the California Bankruptcy Court ordered a stay of the suit by White Front against Esgro in the California Superior Court. A few days thereafter White Front and its affiliated corporations, collectively referred to as White Front, filed a proof of a general unsecured claim in the California Bankruptcy Court in Esgro's Chapter XI proceeding. On May 7, 1973 the California Bankruptcy Court lifted the stay from the continuance of the action in the California Superior Court, and Esgro was authorized to defend the action by White Front and to assert all claims for affirmative relief. On July 27, 1973 Esgro filed its answer in the suit and a cross-complaint seeking aggregate damages of $38,000,000 against White Front, et al.

Almost a year later, i.e. May 22, 1974, Interstate Stores, Inc. and 188 subsidiary corporations, including White Front Stores, Inc. (referred to herein collectively as Interstate Stores), filed petitions in the United States District Court for the Southern District of New York under Chapter XI, §322 of the Bankruptcy Act. On June 13, 1974 the same petitioners amended the application to seek reorganization pursuant to Chapter X of the Bankruptcy Act. The court approved the amendment on the same day and stayed all other proceedings against them. The district court also ordered a general reference of the proceedings to a bankruptcy judge, except to the extent that Chapter X reserved certain matters for

resolution by the district court, and except for the reservation of "the right and jurisdiction to make, from time to time, and at any time, such orders amplifying, extending, limiting or otherwise modifying this order as the Court may deem just and proper." This reservation was repeated in an August 14, 1975 order by the same district judge slightly modifying the general reference.

Meanwhile, in the United States District Court for the Central District of California in the Chapter XI proceeding of Esgro, a plan of arrangement, following several revisions in 1974, 1975 and March and April of 1976, was finally presented, agreed to, and approved by the district court on May 18, 1976, and in the accompanying decree the United States District Court in California expressly reserved jurisdiction "for the purpose of causing to be brought to trial those issues presented by the claim of . . . [Esgro] against White Front Stores, and against Interstate Stores, Inc. and by White Front against . . . [Esgro] and others . . ." to be determined in the plenary action in the Superior Court of California and over the distribution of any proceeds which might be allotted to Esgro.

Sulmeyer, appointed by the Bankruptcy Court for the Central District of California as receiver for the Chapter XI estate of Esgro, filed in the Chapter X proceeding in the Southern District of New York, a proof of claim in excess of $38 million on behalf of Esgro, based upon the same allegations of fraudulent misrepresentations as were raised by Esgro in its cross-complaint in the suit instituted in the California Superior Court.

The Trustees for Interstate filed their objection to Esgro's claim on April 14, 1976. Thereupon Esgro filed a complaint in the bankruptcy court in the Southern District of New York under Rule 10-601 of the Bankruptcy Rules, seeking dismissal of the Trustees' objection to its claim and a modification of the district court's stay on suits in order that the prosecution of Esgro's cross-complaint in the California state court action might go forward in accordance with the instructions of the United States District Court for the Central District of California. The bankruptcy judge in the Southern District of New York held a hearing and issued an order on May 26, 1976, modifying the stay, and directing the parties to apply to the California Superior Court for an advance trial date, to complete discovery on an expedited basis and to report to the bankruptcy court in the Southern District of New York by July 8th, the result of their application to the California state court. The order denied the remaining requested relief. Subsequently, the Trustees moved to expunge Esgro's claim for failure of that firm's president to appear for a scheduled deposition. In denying this motion on June 6, 1976, the bankruptcy judge ordered that all further discovery proceedings involving Esgro's claim and the California suit be conducted under the control of the California state court. Neither ruling by the bankruptcy judge was appealed to the district court.

On July 7, the Trustees for Interstate applied to the bankruptcy court in the Southern District of New York

for an order setting a trial date on the Esgro claim, and informed the bankruptcy court that the California court had set November 15 as the trial date. They argued that that date was not firm and that further delay would hamper the expeditious formulation of a reorganization plan. The bankruptcy judge, however, denied this application on July 23, 1976. The Trustees appealed the denial of their motion to the district court.

On September 1, the district court set aside the bankruptcy court's order and vacated the June 13, 1974 district court order of reference of the Chapter X proceedings to the bankruptcy judge with respect to the Esgro claim.

The district court judge was troubled because the debtors' estates continued to suffer substantial losses from the long delay in getting the case to trial. He resolved to bring all the contending parties before him and to commence forthwith the trial of the issues, including those between White Front and Esgro pending in the state court of California, and assigned October 18, 1976 as the trial date for the case.

Esgro, however, on September 2, 1976, appealed to this court, the district court's order of September 1st, on the ground that the bankruptcy judge's findings were not clearly erroneous and that therefore the district court had no authority to set aside the bankruptcy judge's order and revoke the referral of the case to him. The Chapter X Trustees asserted that the district court's order was not appealable because it did no more than assign a date for the trial. As an adjunct of the appeal to this

court, Sulmeyer, receiver for the Chapter XI estate of Esgro, on November 9, 1976, noticed a motion to suspend and stay the execution of the order of September 1, 1976 by the United States district judge and the then latest assignment of the case for trial on November 18, 1976. Between September 1st and November 9th, however, in spite of the commendable efforts of the district judge, there had occurred further delays, some of which were unavoidable.

The appeal to this court came on for oral argument on October 14, 1976. The motion subsequently noticed, i.e. on November 9th, 1976, by Esgro to suspend and stay the execution of the district court's order of September 1, 1976, was submitted to this court in conjunction with the appeal already heard and held under advisement.

After deliberating on the motion this court granted it on November 23, 1976 to allow the trial in the state court of California to go forward on November 29, 1976, as previously assigned by that court. This court has since been advised that a trial before the court and jury in the Superior Court for the Los Angeles County, State of California has in fact been held and a judgment entered in the case.

There are several factors which, in the opinion of this court, called for the granting of Esgro's motion.

The proceedings in Esgro's Chapter XI in the United States District Court for the Central District of California, derived from White Front's suit brought against

Esgro in the state court of California. The Chapter XI petition was filed and the proceedings commenced in the United States District Court for the California district nearly a year before the XI petition (later Chapter X) was filed in the Southern District of New York by Interstate Stores. The United States District Court in California had designated the California state court as the appropriate tribunal in which to try out, before a judge and jury, the plenary action to adjudicate the contested claims by White Front, Interstate Stores, Inc., et al., on the one hand and Esgro, et al., on the other. Except for lifting the stay as to this particular state court action, all other actions against Esgro were stayed and remained so through the commencement of the Chapter XI (later Chapter X) proceedings re Interstate Stores in bankruptcy in the United States District Court for the Southern District of New York and up to the present time. White Front and its affiliated corporations filed their claims against Esgro's Chapter XI estate in the California bankruptcy court in late March, 1973. An amended proof of these consolidated claims was filed on April 29, 1976. At that time the White Front (Interstate Stores) claim was under the jurisdiction of the California bankruptcy court. In confirmation of Esgro's Chapter XI arrangement, the United States District Court for the Central District of California on May 18, 1976 again restrained and enjoined claimants against Esgro's estate for claims which had existed prior to Esgro's XI petition filed on March 31, 1973, from "initiating any . . . suits or proceedings

. . ." against Esgro. This was plainly applicable to the White Front, et al, claim against Esgro concerning which the United States District Court for Central California had expressly reserved jurisdiction and which was a vital part of the plenary suit in the California state court which the district court had authorized to proceed. It is, therefore, apparent that when on October 21, 1976, the Trustees for the estate of Interstate Stores (including White Front . . . etc), with the approval of the district court in New York, filed a counterclaim, consisting in substance of the same allegations as those in its complaint in White Front Stores v. Esgro in the state court of California and the same as those in White Front's proof of claim in Esgro's Chapter XI proceedings in the California bankruptcy court, the Trustees were acting in contravention of the restraining orders and injunctions issued by the United States District Court for the Central District of California in forbidding the initiation of suits against the debtor, Esgro.

Other factors which were persuasive in designating the California state court as authorized by the United States District Court for the Central District of California as the appropriate tribunal for the determination of the respective claims of White Front Stores (Interstate Stores) et al.,and Esgro, et al., are that the greater part of the potential witnesses are in California, the businesses of the parties were, in the main carried on there, and the fact that a "compelled" trial of the Esgro claims vs. Interstate Stores, et al., in the United States District Court for the Southern District of New York

would have given rise to a number of legal and equitable issues which the district court would first have had to resolve before getting to the actual trial, which would have delayed the decisions on the respective claims for a long time. The discovery and disclosure proceedings in preparation for the California state court trial had been completed, while those in the New York district had barely started. Moreover, at the time of this court's order, the California Superior Court was the only court which had all of the parties before it.

We are satisfied that the interests of justice, the convenience of the parties and the potential witnesses required that execution of the order of the United States District Court for the Southern District of New York entered on September 1, 1976 in this case be suspended and stayed, as was done by this court on November 23, 1976.

As a result of that order of this court and the pursuit of the action by all the parties in the state courts of California, this appeal has become moot and should be dismissed. It is so ordered.

United States Court of Appeals

FOR THE

SECOND CIRCUIT

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IRVING SULMEYER, as Receiver for the Estate of ESGRO, INC., a Debtor in Chapter XI,

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JOSEPH R. CROWLEY and HERBERT B. SIEGEL, as Reorganization Trustees for ~~WHITE FRONT STORES, INC., et al.~~,

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OPINION

ROBERT P. ANDERSON, C. J.

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